Appendix A

APPENDIX A

As a result of discussions held at airport meetings and with personnel at the Arizona Department of Transportation, additional review of the America West situation and fares from the communities was undertaken. The following describes the findings from this review.

1. AMERICA WEST DISCUSSION

In late July 1998, a new code-sharing agreement was signed between America West Airlines and Mesa Airlines. This new agreement is an extension of the alliance between the two airlines that began in October 1992 (there was a brief discontinuation of the alliance before an interim agreement was signed in March 1998).

Officially, the two airlines announced that the new agreement would have three primary benefits:

- More convenient scheduling for connections to America West in Phoenix
- Growth opportunities for both airlines through continued acquisition of larger aircraft
- Increased travel destinations for passengers

What was not noted, officially, was how these benefits would be realized by the traveling public. As part of the new agreement, America West has taken over all pricing and scheduling responsibilities; Mesa's only responsibilities relate to operating the airplanes. This new agreement places much of the burden for success of the two airlines on America West. This action was taken to ensure the long-term viability of Mesa Airlines.

Officials from America West noted that in 16 of the last 18 months (ending September 1998), Mesa lost money on its operations in some Arizona communities. These losses were attributed to several factors including poor yield management of fares and seats, not enough business travelers using the airline service, and poor performance on behalf of Mesa. With the new agreement in place, America West initiated changes to ensure that Mesa's losses did not continue.

One of the first actions taken by America West was to eliminate the 3 and 14-day advance purchase fares to Phoenix in the outlying Arizona markets served by Mesa. This left only 21-day excursion and walk-up fares to Phoenix for customers in the smaller Arizona markets who are served exclusively by Mesa. America West representatives noted that their primary reason for this change relates to making money. The airline is also more interested in filling its airline seats with passengers who are connecting in Phoenix to other America West flights. They are more interested in serving connecting passengers than they are those air travelers who are just flying between the outlying Arizona markets and Phoenix (origin and destination or O&D). With this change, only the walk-up fare has increased; the 21-day excursion fare remained the same. Airline representatives noted that approximately 85 percent of their business is connecting traffic, carrying passengers from the outlying spoke markets to the hub and then out again to their final destination(s). It was estimated that approximately 20 percent of the airline's existing traffic is business related. The airline has indicated it intends to focus on business and connecting markets to increase this share.

The lack of good historic data was also discussed as part of the recent Mesa/America West agreement. America West found that Mesa did not have good historical records on the various markets it serves in Arizona. This lack of data lead to the decision made by America West to drop some of the fare categories. Since the initial changes in the fare categories, some revisions have been made based on meetings between America West personnel and the airports. For instance, a 7-day excursion fare was reintroduced in the Yuma market to respond to concerns voiced to the airline from customers, politicians, and other interested parties. As data is gathered by America West related to Mesa service, it is possible that other changes may occur to respond to each Arizona market's special conditions.

Mesa currently operates five Beech 1900s, seven Dash 8-200s, and three Canadair Regional Jets (CRJs) for America West Express. These 15 aircraft are used to serve 18 cities in Arizona, California, Colorado, Iowa, and New Mexico from the Phoenix hub. The new agreement with America West calls for Mesa to acquire additional Dash 8-200s (for a total of 14) and regional jets (for a total of 12) by the end of 1999. Additional options are contained in the agreement to allow for the purchase of more aircraft in 2000 and 2001. The additional aircraft are intended to be used to grow the America West Express system through new service to more distant cities that can be accessed with the longer range of the CRJs and Dash 8s. In addition, the new aircraft will be used to provide more frequencies where required.

America West officials noted that they intend to continue operating in the existing Arizona markets, including the Essential Air Service (EAS) markets. They also intend to bid on routes needed by the military through the military bidding process in certain Arizona markets, including Sierra Vista and Yuma. As part of their expansion plans for Phoenix and Las Vegas, America West anticipates relying heavily on Mesa for connecting traffic to help the airline grow and expand.

2. FARE DISCUSSION

The setting of airline fares is a process that often appears to defy most forms of conventional logic. As a rule, ticket prices tend to reflect either the presence or the absence of competition on a given route. Competition includes not only service from other airlines in a given market, but can also include airlines at competing airports. Other modes of transportation such as bus shuttles or rail are forms of competition. While yields, defined as profit per seat mile, vary from airline to airline, each carrier typically charges as much as the market will bear in light of demand. The era of equalized fares disappeared when the airline industry was deregulated in 1978.

In the January 1997 report entitled "The Rural Airfare Study," the U.S. Department of Transportation found that on a national basis, there does not appear to be evidence suggesting that fares at smaller communities are excessive when compared to the national average or to other communities. This observation not withstanding, the study also noted that the ability to draw conclusions on the basis of available information is limited because of the relatively small numbers of passengers in many markets. Statistically, average fares based on a total of fewer than 10 daily passengers have limited utility. The study concluded that to adequately assess fares at small communities, as a first step, it would be preferable to obtain ticket information for departures from the departure airport, with detailed specific information with specifics on the type of ticket being purchased.

At the outset of this study, the majority of the markets being analyzed in this study were served only by Mesa Airlines. Although Mesa continues to provide commuter service, a new code-sharing agreement was signed between Mesa and America West that changed the foundation of the service being provided. Historically, Mesa controlled all aspects of its airline, from marketing and pricing to maintaining the aircraft. The new agreement calls for America West to assume all functions not related to maintaining and flying the aircraft. Therefore, the fare structure in place as of October 1998 was notably different from the fare structure in May 1998.

Fares were one of the primary issues discussed throughout the airport meetings held as part of this study in late July 1998. Based on input from airport meetings and subsequent discussions with America West personnel, a fare analysis was conducted to show variations in fares from different Arizona airports to major destinations.

One of the initial changes that occurred when America West assumed pricing responsibilities for Mesa/America West Express service was in the advanced purchase fares. In many markets, the only fares available were walk-up and 21-day advanced purchase. Now, 14-day and 7-day advanced purchase tickets have been reintroduced for some markets. These different fare classes are discussed below.

A. Walk Up Fares

Walk-up, or full-coach fares, were analyzed from each of the Arizona markets included in this study to four different destinations. These destinations are as follows:

- Phoenix
- Los Angeles
- Chicago
- New York

For the majority of the study airports, Phoenix is used as a connecting point to reach the other three destinations. Phoenix is also, however, a top final destination from many of the markets because it is Arizona's Capitol and a major business center. As shown in **Table 1**, fares identified for Grand Canyon are clearly the highest fares of all study airports. Currently, all of the scheduled passenger service provided to and from Grand Canyon Airport is charter/tourist in nature. With most of the scheduled service at Grand Canyon serving tours it is difficult to discuss fares, because most of the fares are obtained through tour packages and are bought in quantity. Therefore, the following discussion of fares does not address Grand Canyon.

Of the walk-up fares to Phoenix, the lowest fare was from Page ($219) and the highest fare was at Yuma ($350). For Los Angeles, the lowest fare was available from Prescott ($290), while Page had the highest fare ($356). It should be noted that among all study airports, only Yuma and the Grand Canyon had less expensive fares to Los Angeles than to Phoenix. Yuma is the only market that actually has nonstop service to Los Angeles; this service is provided by SkyWest/United Express. From all other study airports, the passenger must first fly to Phoenix to connect to another flight to reach Los Angeles. For these other markets, the fare differential between a flight to Phoenix and a connecting flight through Phoenix and then on to Los Angeles was as follows:

- $137 Page
- $60 Prescott
- $40 Flagstaff and Sierra Vista
- $36 Kingman
- $28 Bullhead City and Lake Havasu City

As shown in Table 1, walk-up fares to Chicago and New York were significantly higher. In both cases, the highest fares were from Page while the lowest fares were available from Prescott.

B. Advanced Purchase Fares

In terms of advanced purchase fares, three fare categories were noted as being available in the various airport markets. These categories included 7-day, 14-day, and 21-day. The fares available in each market are denoted in the Table 1 through formatting (i.e., bold=7-day, italic=14-day, and normal=21-day fonts). For Phoenix-bound passengers, all markets except Page offer only 21-day advanced purchase fares. Of the fares to Phoenix and the three other destinations, Yuma had the lowest fares, while the Grand Canyon had the highest fares of the remaining markets, Page's fares were consistently the highest. The only 7-day advanced purchase fares were for Los Angeles departures. All of the Page fares to the four destinations were 14-day advanced purchase.

C. Summary

As observed through the review of Table 1, analyzing fares is a difficult task. On a national level, it is typical for air fares from small communities to reflect the unique marketing and financial agreements of the carriers which serve them. Most often, regional/commuter airlines and their much larger code-sharing partners, the major airlines, have varying types of agreements. As previously noted, fare setting in most of the available markets now rests with America West's yield management department. The fact that Mesa had historically established its own fares is unusual in the airline industry.

Although the actual details of the agreement between Mesa and America West are not open to the public, there are generally only a limited number of methods for determining the revenue made by the regional/commuter carrier. One method gives the regional/commuter carrier a pro-rated share of the total ticket price on a given flight when they are carrying connecting passengers, with a fixed upper limit. Other methodologies give the carrier a fixed amount to carry a connecting passenger to the hub. In many cases, the fare a regional/commuter carrier can charge a non-connecting passenger is determined solely by the regional/commuter carrier.

The recent increases in fares that have been experienced in the Arizona markets are not a unique phenomenon. It is important that the communities monitor their individual fare situation, either through working with local travel agents or with the carrier, to ensure that fare changes are noted and reviewed to determine potential impacts to demand.